FILE COPY

FILED
NOV 28 1936

Nos. 486 and 487

In the Supreme Court of the United States

October Term, 1936

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

METROPOLITAN EDISON COMPANY

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

PENNSYLVANIA WATER & POWER COMPANY

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

INDEX

	Page
Opinions below	2
Jurisdiction	2
Questions presented	2
Statutes and regulations involved	3
Statement	3
Specification of errors to be urged	12
Reasons for granting the writs	13
Conclusion	19
Appendix A	21
Appendix B	27

CITATIONS

Cases:	
American Gas & Elec. Co. v. *Commissioner*, 85 F. (2d) 527	16, 17
American Gas & Electric Co. v. *United States*, 17 F. Supp. 151	16, 17
Athol Mfg. Co. v. *Commissioner*, 54 F. (2d) 230	17
Connecticut Electric Service Co. v. *Commissioner*, 35 B. T. A. 444	17
General Gas & Elec. Corp. v. *Commissioner*, 98 F. (2d) 561	13
Gt. W. Power Co. v. *Commissioner*, 297 U. S. 543	18
Helvering v. *Union Pacific Co.*, 293 U. S. 282	18
Illinois Power & Light Corp. v. *Commissioner*, 33 B. T. A. 1189	17
Merwine v. *Mt. Pocono Light & Imp. Co.*, 304 Pa. 517	15
New Colonial Co. v. *Helvering* 292 U. S. 435	16, 17
New York Cent. R. Co. v. *Commissioner*, 79 F. (2d) 247, certiorari denied, 296 U. S. 653	17
New York, C. & St. L. R. Co. v. *Burnet*, 64 F. (2d) 152	16
Pennsylvania Co., etc. v. *Commissioner*, 75 F. (2d) 719	18
Turber-Farber-Love Co. v. *Helvering*, 68 F. (2d) 416	16
Western Maryland Ry. Co. v. *Commissioner*, 33 F. (2d) 695	17
York Haven Water & Power Co. v. *Public Service Commission*, 287 Pa. 241	10
Statutes:	
Purdon's Pennsylvania Statutes, Annotated (Permanent Ed.), Title 15:	
Sec. 421	27
Sec. 422	27
Sec. 423	15, 28
Sec. 595	6, 10, 13, 29

110492—38——1

Statutes—Continued.

	Page
Revenue Act of 1926, c. 27, 44 Stat. 9:	
Sec. 200	22
Sec. 212	23
Sec. 234	23
Revenue Act of 1928, c. 852, 45 Stat. 791:	
Sec. 23	21
Sec. 41	22
Sec. 43	22
Miscellaneous:	
Rule 38 of the Rules of the Supreme Court of the United States	16
Treasury Regulations 69:	
Art. 545	26
Art. 563	26
Treasury Regulations 74:	
Art. 68	24
Art. 176	25

In the Supreme Court of the United States

OCTOBER TERM, 1938

No. 486

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

METROPOLITAN EDISON COMPANY

No. 487

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

PENNSYLVANIA WATER & POWER COMPANY

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that writs of certiorari issue to review the judgments of the Circuit Court of Appeals for the Third Circuit entered in the above causes on August 23, 1938, reversing the decisions of the Board of Tax Appeals.

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals in the *Metropolitan Edison Company* case (R. 59–83) is reported in 35 B. T. A. 1110, and that of the Circuit Court of Appeals (R. 95–100) is reported in 98 F. (2d) 807. The opinion of the Board of Tax Appeals in the *Pennsylvania Water & Power Company* case (R. 32–44) is reported in 36 B. T. A. 467, and that of the Circuit Court of Appeals (R. 82–84) is reported in 98 F. (2d) 812.

JURISDICTION

The judgments of the Circuit Court of Appeals in the two cases were entered August 23, 1938. (*Metropolitan Edison* case, R. 100; *Pennsylvania Water* case, R. 84–85.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.[1]

QUESTIONS PRESENTED

1. The taxpayer, a Pennsylvania corporation, acquired all of the assets of its wholly owned subsidiary in consideration of the delivery to the sub-

[1] The two cases were not consolidated, either before the Board or the Circuit Court of Appeals, but both tribunals recognized that the two cases presented similar questions and the Circuit Court of Appeals decided the *Pennsylvania Water & Power Company* case upon the authority of the *Metropolitan Edison Company* case, and entered its judgments in the two cases on the same day. For that reason, we are filing a single petition for writs of certiorari.

iary of all of the subsidiary's capital stock and
e assumption by the taxpayer of all of the sub-
iary's indebtedness. This transaction was car-
d out in accordance with Section 595, Title 15,
rdon's Pennsylvania Statutes, *infra*. The tax-
yer, the parent company, retired bonds issued at
liscount by its former subsidiary. Is the tax-
yer entitled to deduct from its gross income the
amortized bond discount and expense in the year
the retirement of the bonds?

2. The facts are the same as in Question 1, ex-
ot that the transaction was not carried out under
y Pennsylvania statute and the subsidiary was
immediately dissolved. Is the taxpayer en-
ed to deduct the unamortized bond discount and
pense in the year of the retirement of the
nds?[2]

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved will be
nd in Appendices A and B, *infra*, pp. 21–30.

STATEMENT

The facts in these cases are not in dispute and
found by the Board of Tax Appeals are sub-
ntially as follows:

---

[2] The first question is presented in both cases. The *Metro-
tan Edison Company* case presents also the second
stion.

METROPOLITAN EDISON CASE

The taxpayer, the Metropolitan Edison Company, is a Pennsylvania corporation which in 1927 and 1928 filed consolidated returns in behalf of itself and its subsidiaries. (R. 62–63.)

The Metropolitan Power Company, also a Pennsylvania corporation, was organized in 1923 as a wholly owned subsidiary of the taxpayer. The taxpayer in 1923 purchased and guaranteed and sold to the public all of the bonds issued by the Metropolitan Power Company, purchased all of its stock, and loaned to that company on open account approximately $3,000,000. The bonds, in the amount of $3,250,000, were issued to the taxpayer at 90 and, after endorsement and guarantee by the taxpayer, were sold to the public at the same price. (R. 63–64.)

On February 15, 1927, the Public Service Commission of the State of Pennsylvania issued a Certificate of Public Convenience authorizing the Metropolitan Power Company to sell all of its property except public franchises to the taxpayer.[3] The actual transfer occurred on February 28, 1927, the assets and liabilities of the Metropolitan Power Company being transferred as they stood on its books and a deficit from operations being charged

[3] The Board found that the petition specifically states that the Metropolitan Power Company had no public franchises and for that reason a sale was resorted to rather than a merger. (R. 64.)

against the surplus of the taxpayer. The taxpayer surrendered the stock of the Power Company for cancellation and the latter became inactive on February 28, 1927, and was dissolved on January 8, 1928. (R. 64.) On February 28, 1927, the taxpayer assumed the liability of the Metropolitan Power Company's $3,250,000 bond issue, the payment of which had been guaranteed by it, and the intercorporate debt of the Metropolitan Power Company to the taxpayer in the sum of $3,000,000 was cancelled. (R. 64.)

The bonds in question were callable on thirty days' notice at a premium, and were called for redemption and redeemed during 1927, the taxpayer paying a premium of $243,645 on their retirement. (R. 64–65.)

At the time of the redemption of the bonds in question there remained of the discount and expense incurred on the issuance of the bonds the sum of $308,097.90 unamortized by annual deductions. That amount was claimed as a deduction in the return of the taxpayer for 1927. (R. 61, 65.)

During the year 1928 the taxpayer also retired certain obligations of the Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Hanover Power Company, and the Pennsylvania Edison Company. (R. 66–67.) Those companies also were former subsidiaries of the taxpayer, whose obligations it had assumed when it took over their assets. (R. 68.)

The so-called mergers of all those companies with the taxpayer were effected under the Act of the General Assembly of the Commonwealth of Pennsylvania, enacted April 29, 1874, and the amendments and supplements thereto. (See Section 595, Title 15, Purdon's Pennsylvania Statutes, Appendix B, *infra*, p. 29; R. 68.)[4] They were made upon application, with the approval of the Public Service Commission of Pennsylvania, under Section 3 (c), Article III, and Sections 18 and 19, Article V, of the Public Service Company Law, and followed the issuance of a report, order and certificate of public convenience. (R. 68.) In each instance the documents relating to the transfer of assets to the taxpayer referred to the transaction as a sale of assets by the subsidiary to the parent corporation. (R. 68, 77–78.)

At the time that these obligations were redeemed there existed unamortized discount and expense with respect to them in the aggregate sum of $752,481.26. (R. 67.) The taxpayer claimed a deduction of that amount in its return for 1928. (R. 68.)

On the basis of the disallowance of the deduc-

[4] The provision in question is Act of April 29, 1874, P. L. p. 73, section 23, as amended by Act of April 17, 1876, P. L. p. 30, section 5, and Act of June 2, 1915, P. L. p. 724, section 1. An inadvertent error at R. 68 refers to the last Act as that of April 2, 1915. Although the manner of presentation in the findings might suggest otherwise, the assets of each of the companies were acquired pursuant to the same statute.

tions for unamortized discount and expense related to these bonds and the Metropolitan Power Company bonds, and because of other adjustments not here involved, the Commissioner of Internal Revenue determined deficiencies of $101,395.24 and $320,017.64 for 1927 and 1928, respectively. (R. 61.)

Upon appeal the Board of Tax Appeals sustained the Commissioner on this issue (R. 75) and determined deficiencies of $21,657.13 and $78,620.55 for 1927 and 1928, respectively. (R. 83.)[5]

The Circuit Court of Appeals reversed the Board. It held that the transactions by means of which the taxpayer absorbed the Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Hanover Power Company, and the Pennsylvania Edison Company, had all of the essential elements of a merger; that the subsidiaries ceased to exist by operation of law; that the taxpayer, an existing corporation before the alleged merger, continued to exist thereafter and became liable for the debts of the absorbed corporation, both under the contract and by operation of law; and hence that it could deduct the unamortized bond discount and expense with respect to the bonds of the subsidiaries.

---

[5] It should be noted that the Board (R. 78–81) held that the taxpayer might deduct unamortized bond discount and expense with respect to bonds issued by another subsidiary, the Metropolitan Electric Company, for the reason that in that instance there was a strict merger or consolidation pursuant to the Act of May 3, 1909, P. L. 408, sec. 1. See Section 421, Title 15, Purdon's Pennsylvania Statutes, Appendix B, *infra*, p. 27.

The court held further that while the procedure by which the taxpayer acquired the assets and assumed the liabilities of the Metropolitan Power Company was not within the provisions of any merger statute, the essential elements of such a merger were present, it not being material that the Power Company did not automatically cease to exist upon completion of the transaction, since it was left without stockholders or property and there was a *de facto* dissolution. Accordingly, the court held that the unamortized bond discount and expense with reference to the Metropolitan Power Company bonds could be deducted.

PENNSYLVANIA WATER CASE

On August 9, 1924, the taxpayer, a Pennsylvania corporation, organized a subsidiary, the Holtwood Power Company, under the laws of Pennsylvania. It acquired all of the stock of that company except that fifty qualifying shares were placed in the names of seven directors, the taxpayer remaining the equitable owner of the latter shares. (R. 33.)

With the funds paid by the taxpayer to its subsidiary for its capital stock and the proceeds received from the sale of the bonds hereinafter mentioned, the subsidiary erected an auxiliary steam-generating plant on a site immediately adjacent to the taxpayer's hydroelectric plant.[4] (R. 33–34.)

[4] It appears that the subsidiary was organized because the energy generated at the taxpayer's plant was insufficient to serve its customers and its counsel believed that its charter did not permit it to generate electricity by steam. (R. 33.)

By an agreement between the two companies dated August 26, 1924, and effective until January 1, 1975 (R. 60–64), the subsidiary agreed to deliver electric power of the steam generating plant to the taxpayer, which in turn agreed to pay all obligations and expenses of the subsidiary and a net return of 8 per cent on the par value of all its securities at any time outstanding. It was specifically provided that the taxpayer should pay a sum to provide for amortization of debt, discount, and security issue expense and the expenses attending the issue, registration and transfer of the capital stock and bonds then or thereafter issued and outstanding, and interest on bonds or other indebtedness. (R. 34, 60–64.)

From the date of the completion of the steam plant on August 16, 1925, to December 21, 1927, all electric energy generated at the steam plant (which was not used constantly) was delivered to the taxpayer. The taxpayer's officers and employees managed the plant without compensation from the subsidiary and it was operated as a department of the taxpayer. (R. 34.)

The funds for construction were secured in part by a mortgage and deed of trust to the New York Trust Company, whereby all the subsidiary's property was transferred to the trustee to secure a bond issue which was not to exceed $25,000,000. It was provided that the bonds might be issued in series and that the first series, limited to $2,750,000, desig-

nated Series A and bearing 6 per cent interest, should be dated September 1, 1924, should mature September 1, 1954, and might be redeemed on various dates at various premiums. (R. 35.)

Series A bonds in the amount of $2,750,000 were issued by the subsidiary at a discount of $137,500, and it incurred an expense of $25,249.87 in issuing them. Deductions for amortized bond discount and expense were claimed in the consolidated returns of the taxpayer and its affiliate for the years 1924 to 1927. Because of the obligation of the taxpayer to make payments to its subsidiary for these items, which payments were deductible as business expenses, the subsidiary reported such payments as income. (R. 35–36.)

On October 4, 1927, the taxpayer surrendered its corporate power to store, transport and supply water in order to be in a position to effect a merger or consolidation with its subsidiary in accordance with the rules laid down in *York Haven Water & Power Co.* v. *Public Service Commission*, 287 Pa. 241. Thereafter, a "short form of merger" was effected pursuant to the Pennsylvania statutes previously mentioned. (See Section 595 of Title 15 of Purdon's Pennsylvania Statutes, Appendix B, *infra*, p. 29; R. 36–37.)[7]

Pursuant to the procedure described in those provisions the subsidiary, by deed dated December

[7] This transaction was treated by the Commissioner as a nontaxable exchange. (R. 37.)

21, 1927, transferred all of its franchises and property, real, personal and mixed, to the taxpayer, the sole consideration for the transfer being the delivery to the subsidiary of its capital stock held by the taxpayer and the taxpayer's assuming the indebtedness of the subsidiary. Thereupon the subsidiary ceased to exist. (R. 37.)

On March 1, 1928, the taxpayer sold to the public a $6,000,000 issue of its own bonds for the purpose of retiring some of its own bonds and the Holtwood bonds. The latter were retired on March 1, 1928, at a 7 per cent premium amounting to $192,500. (R. 37–38.)

On January 1, 1928, the unamortized discount and expense applicable to the Holtwood bonds was $145,159.52. (R. 38.)

In its income tax return for 1928 the taxpayer claimed a deduction of $904.42 for amortization of bond discount and expense for the period January 1, 1928, to February 28, 1928, and a deduction for unamortized discount and expense, as of the date of retirement, in the amount of $144,255.10. (R. 38.)

The Commissioner disallowed these deductions, made certain other adjustments which are not material here, and determined a deficiency of $86,508.25, but made claim for a deficiency of only $39,675.82 at the trial. (R. 32–33.)

Upon appeal the Board of Tax Appeals sustained the Commissioner's determination and found a deficiency of $16,575.82. (R. 45.)

The Circuit Court of Appeals reversed the Board, holding that its decision in the *Metropolitan Edison Company* case, rendered the same day, controlled this case, and hence that the deductions should be allowed.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that a transfer of assets from one Pennsylvania corporation to another by an agreement pursuant to Section 595, Title 15, of Purdon's Pennsylvania Statutes effects a merger or consolidation. (Nos. 486, 487.)

2. In holding that where the successor corporation under such a contract agrees to pay the transferor's debts, it is liable for such debts by operation of law. (Nos. 486, 487.)

3. In holding that the Metropolitan Edison Company was merged or consolidated with the Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Hanover Power Company, and the Pennsylvania Edison Company, or with any one of those companies. (No. 486.)

4. In holding that the Metropolitan Edison Company became liable for the debts of those companies by operation of law. (No. 486.)

5. In holding that when bonds issued by those corporations are redeemed by the Metropolitan Edison Company, that company should be allowed a deduction for the unamortized discount and expense. (No. 486.)

6. In holding that there was a merger or consolidation of the Pennsylvania Water & Power Company and the Holtwood Power Company. (No. 487.)

7. In holding that the Pennsylvania Water & Power Company became liable for the debts of the Holtwood Power Company by operation of law. (No. 487.)

8. In holding that when bonds issued by the Holtwood Company are redeemed by the Pennsylvania Water & Power Company, that company may deduct the unamortized bond discount and expense. (No. 487.)

9. In holding that the Metropolitan Edison Company became liable for the debts of the Metropolitan Power Company by operation of law. (No. 486.)

10. In holding that when bonds issued by the Metropolitan Power Company are redeemed by the Metropolitan Edison Company, that company is entitled to deduct unamortized bond discount and expense. (No. 486.)

REASONS FOR GRANTING THE WRITS

1. The decisions of the court below are in conflict with the decision of the Circuit Court of Appeals for the Second Circuit in *General Gas & Elec. Corp.* v. *Commissioner*, 98 F. (2d) 561. In that case the taxpayer, a Pennsylvania Corporation, acquired the assets of each of two subsidiaries, surrendering the capital stock of and assuming the

debts of each subsidiary. The transaction was carried out in accordance with Section 595, Title 15, Purdon's Pennsylvania Statutes (Appendix B, *infra*, p. 29), hereinafter referred to as the "Short-Form-Merger Statute." The question involved was whether in the year of its retirement of the subsidiary's bonds, 1928, the taxpayer could deduct the unamortized discount and expense incurred by the subsidiaries in issuing the bonds. The Circuit Court of Appeals held that the deductions were not allowable to the taxpayer, for the reason that it was not a successor corporation which through merger or consolidation had carried forward the corporate identity of the issuing corporations and assumed the liabilities of its predecessors by operation of law. Thus the case presented precisely the same question as the instant cases, and involved the same Federal statutes and regulations and the same provisions of the Pennsylvania statutes.[8] The court there held that a transfer of assets and the assumption of liabilities effected under the Short-Form-Merger Statute of Pennsylvania did not carry forward the identity of the corporation which issued the bonds and did not make the successor corporation liable for debts of the old by operation of law, and hence that the latter could not claim the deduction.

---

[8] Both the instant cases involve the year 1928, but the *Metropolitan Edison* case also involves the year 1927. There was, however, no material difference in the statutes and regulations applicable to that year.

In these cases the court below held directly to the contrary, stated (R. 97) that "the petitioner became liable for the debts of the absorbed subsidiaries both under the contract and by operation of law", and allowed the deductions to the successor corporations. Both courts considered the applicable Pennsylvania decisions and reached opposite conclusions as to the effect of the Short-Form-Merger Statute.

In construing the Pennsylvania statute the court below relied primarily upon the fact that the Pennsylvania courts had often referred to transactions effected under it as mergers, and upon the fact that for a long time it was the only method for effecting mergers as distinguished from consolidations. The statute itself uses the word "sale", and is in contradistinction to Section 423, Title 15, Purdon's Pennsylvania Statutes (Appendix B, *infra*, pp. 28–29) which expressly provides that "all debts" of each constituent corporation "shall thenceforth attach to the said new corporation."

In what the court below conceded was the only Pennsylvania case dealing with the question whether under that statute the successor corporation is liable for the debts of the selling corporation by operation of law, it was held that the seller's creditor could not sue the successor, and the court indicated, as a possible basis of liability of the successor, only the principle of fraudulent conveyance. *Merwine* v. *Mt. Pocono Light & Imp. Co.*,

304 Pa. 517. The court below declined to follow that case but cited no Pennsylvania decisions overruling it. It is believed that the court below plainly erred in declining to follow the *Mt. Pocono* case and that the Circuit Court of Appeals for the Second Circuit properly accepted that decision as controlling in its construction of the Pennsylvania statute.

Thus, there is a two-fold basis for invocation of Rule 38 of this Court. The court below not only "rendered a decision in conflict with the decision of another circuit court of appeals on the same matter" but it also "decided an important question of local law in a way probably in conflict with applicable local decisions."

2. In so far as the court below in the *Metropolitan Edison* case held that the taxpayer could deduct unamortized bond discount and expense with reference to the Metropolitan Power Company bonds, notwithstanding the fact that the transfer of assets and the assumption of liabilities was not effected pursuant to any merger or consolidation statute, its decision conflicts in principle with several decided cases which have denied the deduction of unamortized discount and expense to a successor corporation with respect to bonds issued by a predecessor, where there has not been a strict merger or consolidation. *American Gas & Elec. Co.* v. *Commissioner*, 85 F. (2d) 527 (C. C. A. 2nd); *American Gas & Electric Co.* v. *United States*, 17 F. Supp. 151 (C. Cls.); *Turner-Farber-Love Co.* v. *Helvering*, 68

. (2d) 416 (App. D. C.).* See, also, *New York, . & St. L. R. Co.* v. *Burnet,* 64 F. (2d) 152 (App. . C.).

This conflict is not resolved by the court's asser-ion that there was a *de facto* dissolution of the Metropolitan Power Company, even though it was ot formally dissolved until 1928. The only theory pon which a successor corporation has been al-owed the deduction in any case is that the life of he transferor corporation has been continued in he new corporation, so that the deduction is not eing allowed to a new or different taxpayer but o the original taxpayer whose personality is con-inued by operation of law in and through the suc-essor corporation. *American Gas & Elec. Co.* v. *Commissioner, supra; American Gas & Electric o.* v. *United States, supra; New York Cent. R. Co. . Commissioner,* 79 F. (2d) 247 (C. C. A. 2nd), ertiorari denied, 296 U. S. 653; *Western Mary-nd Ry. Co.* v. *Commissioner,* 33 F. (2d) 695 (C. C. A. 4th); *Illinois Power & Light Corp.* v. *Commissioner,* 33 B. T. A. 1189; *Connecticut Elec-ric Service Co.* v. *Commissioner,* 35 B. T. A. 444.

No other theory would support the allowance of he deduction, for one corporation is not entitled o a deduction which the law grants to another. *New Colonial Co.* v. *Helvering,* 292 U. S. 435; *Athol Mfg. Co.* v. *Commissioner,* 54 F. (2d) 230 (C. C. A. 1st). The court below itself recognized

*That decision was cited with approval by this Court in he case of *New Colonial Co.* v. *Helvering,* 292 U. S. 435, 442.

that principle in an earlier decision involving a different kind of deduction. See *Pennsylvania Co., etc.* v. *Commissioner,* 75 F. (2d) 719 (C. C. A. 3d).

There are no express statutory provisions relative to the allowance of a deduction for amortization of bond discount, but Treasury Regulations have authorized the deduction and have provided that if the bonds are redeemed before maturity, the unamortized bond discount may be deducted at that time. See Article 68 of Regulations 74 (Appendix A, *infra,* p. 24). These regulations have been sustained by this Court (*Helvering* v. *Union Pacific Co.,* 293 U. S. 282), and a like principle has been applied to expenses incurred in issuing bonds (*Gt. W. Power Co.* v. *Commissioner,* 297 U. S. 543). The theory of the deduction is that the taxpayer issuing the bonds has a loss or an expense which should properly be spread over the life of the bonds.

This reasoning does not apply to a successor corporation which has taken over the assets of the corporation issuing the bonds and agreed to pay its debts. The successor has directly incurred no expense and, even if the value of the assets received is less than what was given for them (including the total of the predecessor's obligations which it is to pay), no loss has then been realized. When the loss is realized, deductibility would seem to depend upon provisions dealing with the recognition of gains or losses from sales. Any loss incurred does not represent bond discount or expense which may properly be amortized under the regulations.

The courts, therefore, should have held that in no case does the successor corporation have the right to the deductions for amortization of bond discount and expense during the life of the bonds or for the unamortized bond discount and expense upon the retirement of the bonds. But they have not gone so far. Instead, they have granted the allowance where there is a strict statutory merger or consolidation which preserves the identity of the transferor corporations in the successor corporation and makes the successor liable for the debts of the transferor by operation of law. We question the soundness of such decisions. In these cases, however, the court has gone further and allowed the successor the deduction, even though the transferor corporation itself had not been dissolved and there was no statutory merger or consolidation.

3. The question arising in these cases is of general importance. The decision in the *Metropolitan Edison* case clearly creates a new rule for determining when a successor corporation shall be allowed to deduct amortization of bond discount and expense with respect to bonds issued by its predecessor; and the decision, if allowed to stand, is likely to create confusion regarding the correct rule to be applied in the case of successor corporations in all States and not merely in Pennsylvania.

CONCLUSION

Because of the direct conflict of authorities, and because of the general importance of the question

involved, it is respectfully submitted that this petition for writs of certiorari should be granted.

ROBERT H. JACKSON,
Solicitor General.

NOVEMBER, 1938.

APPENDIX A

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

(b) *Interest.*—All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title.

* * * * *

(f) *Losses by corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * *

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year. * * *

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period.

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 200. When used in this title—

* * * * *

(d) The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212 or 232. The deductions and credits provided for in this title shall be taken for the taxable year in which

"paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed under section 212 or 232, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period.

* * * * *

SEC. 212. (b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

SEC. 234. (a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, and including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity;

(2) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities

(other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title;

* * * * *

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise. * * *

* * * * *

Treasury Regulations 74:

ART. 68. *Sale and retirement by corporation of its bonds.*—(1) (*a*) If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price or face value, the excess of the purchase price over the issuing price or face value is a deductible expense for the taxable year. (*c*) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year.

(2) (*a*) If bonds are issued by a corporation at a premium, the net amount of such premium is gain or income which should be prorated or amortized over the life of the bonds. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price minus any amount of premium already returned as income, the excess of the purchase price over the issuing price minus any amount of premium already returned as income (or over the face value plus any amount of premium not yet returned as income) is a deductible

expense for the taxable year. (*c*) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price minus any amount of premium already returned as income, the excess of the issuing price minus any amount of premium already returned as income (or of the face value plus any amount of premium not yet returned as income) over the purchase price is gain or income for the taxable year.

(3) (*a*) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price plus any amount of discount already deducted, the excess of the purchase price over the issuing price plus any amount of discount already deducted (or over the face value minus any amount of discount not yet deducted) is a deductible expense for the taxable year. (*c*) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price plus any amount of discount already deducted, the excess of the issuing price plus any amount of discount already deducted (or of the face value minus any amount of discount not yet deducted) over the purchase price is gain or income for the taxable year.

ART. 176. *Sale of capital stock, bonds, and capital assets.*—A corporation sustains no deductible loss from the sale of its capital stock. (See article 66.) If it sells its bonds at a discount, the amount of such discount is treated in the same way as interest paid, and if it retires its bonds at a price in excess of the issuing price, such excess may usually be deducted as expense. (See article

68.) Any loss sustained by a corporation upon the sale of its capital assets, computed as provided in sections 111–113 and articles 561–604, subject to the limitation provided in section 118 as to the purchase and sale of stock or securities, is deductible.

Inasmuch as Articles 545 and 563 of Regulations 69 are identical in all material respects with Articles 68 and 176 of Regulations 74 above quoted, they are not set forth separately.

APPENDIX B

Purdon's Pennsylvania Statutes, Annotated (Permanent Edition), Title 15:

SEC. 421. *Merger authorized; exceptions; exclusive franchise not extended; merger subject to act of 1907*

It shall be lawful for any corporation, now or hereafter organized under the provisions of any general or special act of Assembly authorizing the formation of any corporation or corporations, to merge its corporate rights, franchises, powers, and privileges with and into those of any other corporation or corporations transacting the same or a similar line of business, so that by virtue of this act such corporations may consolidate, and so that all the property, rights, franchises, and privileges then by law vested in either of such corporations, so merged, shall be transferred to and vested in the corporation into which such merger shall be made: * * *

SEC. 422. *Procedure; joint agreement; approval by stockholders; certificates; approval by governor*

Said merger or consolidation shall be made under the conditions, provisions, and restrictions, and with the powers, herein set forth; to wit,—

First. The directors of each corporation shall enter into a joint agreement, under the corporate seal of each corporation, for the merger and consolidation of said corporations; prescribing the terms and conditions thereof, the mode of carrying the

same into effect, the name of the new corporation, the number and names of the directors and other officers thereof, and who shall be the first directors and officers, and their places of residence, the number of shares of the capital stock, the amount or par value of each share, and the manner of converting the capital stock of each of said corporations into the stock of the new corporation, and how and when directors and officers shall be chosen, with such other details as they shall deem necessary to perfect the said consideration and merger; but said agreement shall not be effective unless the same shall be approved by the stockholders of said corporations, in the manner hereinafter provided.

Second. Said agreement shall be submitted to the stockholders of each of said corporations, at separate special meetings or at any annual meetings, of the time, place and object of which respective meetings due notice shall be given by publication, once a week for two consecutive weeks before said respective meetings, in at least one newspaper in the county or in each of the counties in which the principal office of said respective corporations shall be situate * * *

SEC. 423. *Effect of merger; new patent; bonus; certificate of reports and payment of taxes*

Upon the filing of said certificates and agreement, or copy of the agreement, in the office of the Secretary of the Commonwealth, and upon the issuing of new letters patent thereon by the Governor, the said merger shall be deemed to have taken place, and the

said corporations to be one corporation under the name adopted in and by said agreement possessing all the rights, privileges, and franchises theretofore vested in each of them; and all the estate and property, real and personal, and rights of action, of each of said corporations, shall be deemed and taken to be transferred to and vested in the said new corporation, without any further act or deed: Provided, That all rights of creditors and all liens upon the property of each of said corporations shall continue unimpaired, limited in lien to the property affected by such liens at the time of the creation of the same, and the respective constituent corporations may be deemed to be in existence to preserve the same; and all debts not of record, duties, and liabilities of each of said constituent corporations shall thenceforth attach to the said new corporation, and may be enforced against it to the same extent and by the same process as if said debts, duties, and liabilities had been contracted by it. * * *

SEC. 595. *Reduction of capital stock; change in value of shares; conveyance of franchise and property*

Any corporation created under the provisions of this act, and any corporation of the classes named in the second section hereof, that is now in existence by virtue of any law of this Commonwealth, may reduce its capital stock or alter and change the par value of the shares thereof, by a vote of the stockholders taken in the manner and under the regulations prescribed in the eighteenth, nineteenth, twentieth, twenty-first and twenty-second sections of this act; and it shall be lawful for any corporation in the same manner to sell, assign, dispose of and

convey to any corporation created under or accepting the provisions of this act, its franchises, and all its property, real, personal and mixed, and thereafter such corporation shall cease to exist, and the said property and franchises not inconsistent with this act, shall thereafter be vested in the corporation so purchasing as aforesaid: Provided, That the returns required by said section shall not be filed in the office of the Secretary of the Commonwealth until each and every corporation, so selling, assigning, disposing, and conveying such franchises and property, shall have filed with the Secretary of the Commonwealth a certificate from the Auditor General of the Commonwealth, setting forth that all reports required by the Auditor General of the Commonwealth have been duly filed to the date of the proposed sale, assignment, disposition and conveyance; and that all taxes due the Commonwealth of Pennsylvania have been paid up to and including such date.

U. S. GOVERNMENT PRINTING OFFICE: 1939